Premium funding for the future

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ADVICE SKILLS AND TRAINING

TAL / Risk Academy

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Learning Outcomes

At the conclusion of this webinar on funding solutions, participants should be able to:

- Understand how the Code of Ethics applies to the premium funding component of insurance advice
- Ensure that premium funding solutions recommended cover the long-term impact on clients and beneficiaries under the insurance policy
- Demonstrate specific premium funding strategies which provide positive outcomes for the client
- Provide appropriate tax, superannuation and estate planning solutions in the area of insurance premium funding

Resources

SLIDES

Copies of the slides will be forwarded to all attendees via email

CPD TEST

A CPD test will be available to you on completion of this webinar

ADDITIONAL SUPPORT

For materials discussed or questions arising from this webinar, please contact your TAL Sales Manager. For more technical support, contact askanexpert@tal.com.au

Agenda

01 Code of Ethics Trinity Test

02 Premium funding evaluating methodology

03 Premium funding case study

04 Way forward

Code of Ethics trinity test

Code of Ethics "Trinity" Test

The funding of an insurance premium should satisfy this test

Standard 2: Advisers must act with integrity and in the best interests of all of their clients

Standard 5: all advice and financial products must be in the best interests of the client and appropriate to client circumstances

Standard 6: You must take into account the broad effects arising from the Client acting on your advice

The Trinity Test is applicable at both advice implementation and review

Best Interests

Best Interests is a requirement of both Section 961B Corporations Law and Standards 2 & 5

COST
Is the premium funding solution reasonable on the basis cost versus benefit?

AFFORDABILITY
Does the client have the financial means or capacity to fund the insurance solution being proposed?

RISK
Has the premium funding structure delivered against the client's prioritised goals and objectives, balanced against their risk tolerance?

Example

Is it reasonable for the premium funding arrangement to reduce the amount the client can use to make additional contributions to superannuation or pay down debt?

Look at the client's position before and after the funding arrangement. Can you articulate an improvement in the Client's position as a result of the funding arrangement?

Appropriateness

Standard 5 requires the insurance premium funding arrangement proposed to be appropriate to the client's circumstances

- The test is objective. It is not your perception of appropriateness, but that of the reasonable adviser
- Appropriateness needs to show a strong link between the client's circumstances outlined in the fact find and the objectives, financial situation and needs of the client identified in the needs analysis
- Risk. Are there any elements of the premium funding structure which are not compatible with a client's risk profile?

Example

Is it appropriate to use a superannuation rollover for the premium funding arrangement, rather than funding via the superannuation cash account?

Scrutinise the premium funding arrangement. If an officious bystander challenged you to justify the arrangement on the basis of appropriateness, could you defend your position?

Broad effects

Standard 6 requires the insurance premium funding arrangement proposed to be evaluated for its broad effect on the client

- The test needs to examine the insurance funding arrangement over its lifetime and not simply the first year of the arrangement
- The test needs to consider the impact of the premium funding arrangement on the client. This would involve considerations of premium affordability over the estimated life of the arrangement
- The assessment should also consider the impact on those associated with the client, including family members.

Example

Is it in the client's long-term interests to use the client's superannuation balance to fund the insurance premiums? Is their a strategy to review the client's funding mechanism over the medium to long-term?

Review the premium funding arrangement to ensure that it meets best interest and appropriateness requirements over the estimated term of the insurance policy.

How does the funding impact the client and their family over this period?

Premium funding evaluation methodology

Premium funding methodology

1. Importance of mapping
2. Mapping process
3. Risk evaluation
4. Costing the premium funding solution
5. Sanity Check

A picture is worth a thousand words

Map presents the funding solution in understandable form

Assists meeting the Client's expectations by creating a clear picture of the funding solution

Importance of mapping

Enables legal and tax advisers to evaluate the funding solution quickly and efficiently

Provides evidence in the event of licensee or regulator query

Output provides peace of mind for the client

Mapping process

A map has two components: the entities and cash flows involved in the funding process

Entities

- Identify all entities involved in the premium funding process
- Superannuation funds
- Family trusts
- Corporate entities

Cash flows

- Identify all cash flows involved in the funding process
- Super contributions
- Premiums
- Rollovers

Ensure that your picture accurately represents the proposal under consideration

Risk evaluation

Using the map, identify potential obstacles by a risk review

Tax risk review: consider tax outcomes from the perspective of deductibility and assessability

Is there any legal risk standing in the way of the insurance funding solution? e.g. an income protection contract owned by an employing entity

Is there any regulatory risk? e.g. Does the funding solution comply with superannuation regulations?

Costing the premium funding solution

Initial projections

- Cash flows should be on a after tax basis
- Treat tax as an expense
- Use the marginal tax rate of the Client to determine after tax cost
- Establish the likely life of the insurance arrangement
- Project premium flows over the life of the insurance contract

Evaluation process

- Consider the premium increases as the client ages
- Consider stepped v level premium structures
- Include the erosion of superannuation balances caused by the premiums
- Project the loss of superannuation earnings

Costing over the long-term is always a “best estimate”. Ensure that the costing method used can withstand scrutiny

Sanity check

The Sanity Check involves the adviser exercising professional judgement

Does the premium arrangement meet client expectations on cost?

Does the benefit of the funding arrangement exceed the cost over the life of the insurance contract?

Does the funding arrangement meet the best interest and appropriateness requirement of Standards 2 and 5 of the Code of Ethics?

Does the arrangement satisfy the long term requirements of Standard 6 of the Code?

Premium funding case study

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Premium funding case study

Client is considering taking an income protection policy on the following basis

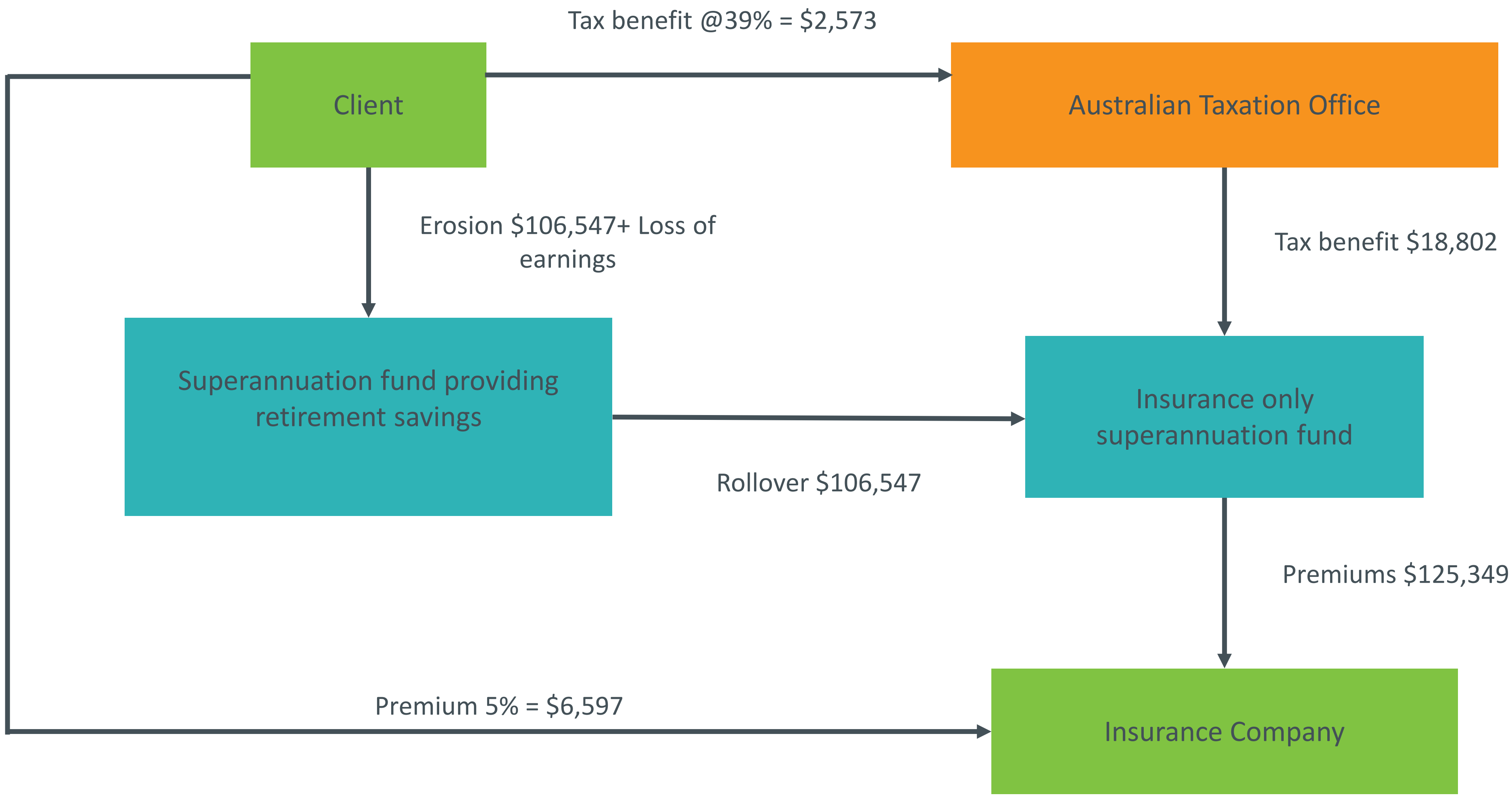
- Male, Non-Smoker
- Age 47
- White-collar, $150k income per annum
- $8,750 per month benefit
- 30 day wait, to age 65, stepped premiums
- Client lacks cash flow and wants to fund the insurance arrangement from accumulated balance in his superannuation

Premium projections

Project premiums over the life of the policy

Policy Year	Client Age	Annual Premium $	Cumulative Premiums $	Policy Year	Client Age	Annual Premium $	Cumulative Premiums $
1	48	3,166	3,166	10	57	8,775	57,946
2	49	3,566	6,733	11	58	9,562	67,509
3	50	4,084	10,816	12	59	10,145	77,654
4	51	4,694	15,510	13	60	9,921	87,575
5	52	5,289	20,799	14	61	10,672	98,247
6	53	5,989	26,788	15	62	11,026	109,272
7	54	6,766	33,554	16	63	11,391	120,661
8	55	7,551	41,106	17	64	11,284	131,947
9	56	8,066	49,172				

Map



Tax benefit @39% = $2,573
Client
Australian Taxation Office
Erosion $106,547+ Loss of earnings
Tax benefit $18,802
Superannuation fund providing retirement savings
Insurance only superannuation fund
Rollover $106,547
Premiums $125,349
Premium 5% = $6,597
Insurance Company

Risk Evaluation – Tax risk

Test insurance premium funding solution for key tax risks:

Portion of the premium paid by client. This is tax deductible

The after tax cost = premium cost@61%. The client's marginal tax rate is 39%

The rollover to the insurance only fund is tax free

The tax benefit for the premium deduction is 15% of the premium cost. The benefit to the client flowing via a 15% reduction in the rollover amount is not assessable to the Client

Risk Evaluation – Legal risk

Test the insurance premium funding solution for key legal risks:

No contractual nexus between the client and the life insurer

The Trustee of the insurance only superannuation fund owes a fiduciary duty to the client

The policy contract is is an individual contract between the trustee of the superannuation fund and the life insurer. Therefore, the legal risk profile differs from that of a group policy

No disclosure issues if the client has taken reasonable steps to disclose all relevant information

Risk Evaluation – Regulatory risk

Test the insurance premium funding solution for key regulatory risks:

Rollover is permitted by the SIS Rules

The income protection insurance offered by the insurance only superannuation fund complies with Regulation 4.07D

Any risk of non-compliance with Regulation 4.07D will be dealt with by paying any benefit via the contract outside superannuation

The income protection contract complies with the Sole Purpose Test as it offers nominal amount of death cover ($10,000)

Loss of super fund earnings

Year	Opening Balance	Annual Cost	Earnings Lost	Closing Balance	Year	Opening Balance	Annual Cost	Earnings Lost	Closing Balance
1	0	2,557	0	2,557	10	50,097	7,086	3,507	60,690
2	2,557	2,880	179	5,615	11	60,690	7,721	4,248	72,660
3	5,615	3,298	393	9,306	12	72,660	8,192	5,086	85,938
4	9,306	3,790	651	13,748	13	85,398	8,011	6,016	99,965
5	13,748	4,271	962	18,981	14	99,965	8,618	6,998	115,580
6	18,981	4,836	1,329	25,146	15	115,580	8,903	8,091	132,574
7	25,146	5,464	1,760	32,369	16	132,574	9,198	9,280	151,052
8	32,369	6,097	4,268	40,733	17	151,052	9,112	10,574	170,738
9	40,733	6,513	4,103	50,097		TOTAL	106,547	64,191	

Annual cost = Amount rolled over
Earnings Lost = Opening Balance * annual earnings rate after tax
Annual Earnings rate after tax = 7% per annum

Erosion calculation

Premium funded from super	$125,349
15% Rebate	$ 18,802
Portion of premium paid ex super	$106,547
Loss of earnings @7% rate per annum	$ 64,191
Total Erosion of Super Balance	$170,738

Consider reducing the impact of erosion by making contributions into superannuation

Erosion calculation has two components: net reduction in the superannuation balance caused by the premium payments plus the erosion created by loss of earnings

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Way forward

Way forward

Map and evaluate

Capture the cost of the insurance arrangement over the life of the contract

Consider alternative funding structures

Stress test your conclusion, how does my funding recommendation look if queried in later years?

Thank you